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July 3, 2013

Via E-mail

Elizabeth M. Murphy,  
Secretary,  
Securities and Exchange Commission,  
100 F Street, NE,  
Washington, DC 20549-1090.

Re: Rule Change Relating to Filings Under  
FINRA Rule 5123 (Private Placements) –  
File No. SR-FINRA-2013-026

Dear Ms. Murphy:

We appreciate the opportunity to comment on the change to Rule 5123 recently adopted by the Financial Industry Regulatory Authority, Inc. (“FINRA”). The rule change requires member firms to respond, in any filings made under Rule 5123, to six questions relating to the issuer and the securities in the covered private placement. While the amended Private Placement Form (the “Form”) purports to allow the members to respond “unknown” to these questions if the member does not have the requested information, in most (if not all) cases we expect a response of “unknown” would in fact be viewed as inconsistent with the member’s due diligence obligations described in FINRA Notice to Members 10-22 (April 2010). As a practical matter, we therefore expect that the six questions will effectively come to define the scope of members’ due diligence obligations in respect of the points covered. But several of the questions use vague and ambiguous, and potentially very broad, terminology, meaning that the scope of the required due diligence inquiry will have been changed and effectively broadened. The questions also overlap in substance with, but do not seem to take into account, the

pending changes to Rule 506, mandated by Section 926 of the Dodd-Frank Act, to add a “bad actor” disqualification to that Rule. In addition, FINRA does not address for whom, or on whose behalf, the filing member firm is responding with respect to the six questions. We therefore feel strongly that the rule change should have been subject to the notice and comment process, and should not have been made immediately effective.

In its Rule 19b-4 submission, FINRA asserted that the Form, with its six questions, “does not impose any obligation on broker-dealers to seek out information that they do not already have.” The problem with that assertion is that some of the questions, while touching on areas the member clearly has an obligation to investigate, are phrased more broadly than the due diligence obligation has commonly been understood to reach. For example, the sixth question asks the member whether “the issuer, any officer, director or executive management of the issuer, sponsor, general partner, manager, advisor or any of the issuer’s affiliates has been the subject of SEC, FINRA or state disciplinary actions or proceedings or criminal complaints within the last 10 years.” FINRA has suggested that a reasonable investigation with respect to Regulation D securities would include an inquiry “about previous or potential regulatory or disciplinary problems of the issuer” as well as any regulatory or disciplinary history on the part of the issuer’s management. FINRA Notice to Members 10-22, at p. 9. But the sixth question calls for information with respect to “any of the issuer’s affiliates,” and with respect to any disciplinary actions or proceedings, even if the matter was resolved in the relevant person’s favor. We submit that at least in these respects, the question requests information above and beyond what most market participants might have expected or considered relevant.

The sixth question is also substantially broader than the proposed Regulation D “bad actor” provisions, mandated by Section 926 of the Dodd-Frank Act, which will disqualify from Rule 506 offerings involving issuers and/or issuer insiders who were subject to various actions or proceedings resulting in an order, judgment or decree. Does this mean that when the “bad actor” provisions come into effect, members

will need to collect two sets of overlapping information – one for Regulation D purposes, and one to respond to the sixth question? Or alternatively, will the sixth question effectively supersede the more carefully crafted – after notice and comment – provisions of Regulation D in this regard?

At the same time, the sixth question is in several respects *narrower* than the proposed Regulation D “bad actor” provisions. For example, the sixth question does not appear to cover “issuer predecessors”, “promoters” or “compensated solicitors”. Nor does it appear to cover suspension or expulsion from a national securities exchange. If this information will need to be captured, upon adoption of the “bad actor” provisions, for purposes of Regulation D compliance, should it not also be encompassed in the FINRA Form questions?

Also problematic is the third question on the Form, which asks the member firm whether “the issuer is able to use offering proceeds to make or repay loans to, or purchase assets from, any officer, director or executive management of the issuer, sponsor, general partner, manager, advisor or any of the issuer’s affiliates”. We expect that a response of “unknown” would be seen as running counter to FINRA’s previously articulated position that “a [broker-dealer] in a Regulation D offering *should, at a minimum*, conduct a reasonable investigation concerning . . . the intended use of proceeds of the offering.” See FINRA Notice to Members 10-22, at p. 5 (emphasis added). A response of “unknown” would therefore likely be seen as an acknowledgement that the member has not fulfilled its suitability responsibilities. But what is the meaning of “able to use”? Does it refer to ability, as a practical matter? Or as a contractual, or a regulatory, matter? And why does the question relate to “ability”, as opposed to the issuer’s intentions? Use of proceeds disclosure has traditionally been seen – including in the context of registered offerings – as relating to the issuer’s intentions; why does the third question appear to take a different approach?

In a similar vein, we would also urge FINRA to consider defining the term “contingency offering”, used in the first question. We understand that this term may be intended to refer to offerings coming within the ambit of Rule 15c2-4, but even if that is a correct understanding, we believe the point should be made clear, as a matter of public record, rather than by informal advice.

Finally, Rule 5123(a) allows members participating in a covered private placement with other members to designate a member to submit to FINRA on behalf all participating members the offering materials and the Form. It is unclear what obligation the designated member assumes with respect to the other participating members in responding to these additional questions. Is the designated member responding as to the knowledge of all participating members, or only as to its own knowledge? If the member is responding on behalf of all the participating members, what obligation does that member firm have in confirming the other members’ knowledge of the requested information? If the member firm is responding to these questions only for itself, do the other participating members risk failure to comply with Rule 5123 if they do not separately submit a Form in connection with the private placement?

As we hope has been made clear by the foregoing quick review, there are a number of substantial questions raised by the addition of the six questions to the Form. It may well be that after further deliberation FINRA determines to adopt something substantially similar to the recent rule change. But the rule change would still benefit from clarification of the points discussed above, and from possible harmonization with the proposed Regulation D “bad actor” provisions, as well as from consideration of the many other points that we expect would be raised in the notice and comment process.

\* \* \*

Elizabeth M. Murphy

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Once again, we appreciate the opportunity to submit these comments. If you have any questions, please contact Robert Buckholz at 212-558-3876 or David Harms at 212-558-3882.

Very truly yours,

A handwritten signature in cursive script that reads "Sullivan & Cromwell LLP". The signature is written in dark ink and is positioned above the printed name of the firm.

Sullivan & Cromwell LLP